**DEPARTMENT OF STATE REVENUE**

02-20180059R.ODR

**Final Order Denying Refund: 02-20180059R**
**Corporate Income Tax**
**For the Year 2010**

**NOTICE:** IC § 4-22-7-7 permits the publication of this document in the Indiana Register. The publication of this document provides the general public with information about the Indiana Department of Revenue's official position concerning a specific set of facts and issues. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Final Order Denying Refund.

## HOLDING

Medical Research Company's request for a refund of corporate income tax, based on a federal decision recharacterizing its Indiana source income, was untimely; Medical Research Company failed to provide notice of the Indiana refund within 180 days of the date of the IRS's decision as required by the Indiana law in effect at the time of that decision.

## ISSUES

### I. Corporate Income Tax - Amended Apportionment Factor.

**Authority:** IC § 6-3-2-2(f); IC § 6-3-2-2(g); IC § 6-8.1-5-1(c); .IC § 6-8.1-5-2(i); *Dept. of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579 (Ind. 2014); *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463 (Ind. 2012); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480, (Ind. Tax Ct. 2012); *Scopelite v. Indiana Dep't of Local Gov't Fin.,* 939 N.E.2d 1138 (Ind. Tax Ct. 2010); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289 (Ind. Tax Ct. 2007); 45 IAC 3.1-1-153.

Taxpayer argues that the Department of Revenue erred when it declined to accept its revised apportionment factor attributable to a federal adjustment of its corresponding federal income tax return and, as a result, issued Taxpayer a proposed assessment of additional corporate income tax.

### II. Corporate Income Tax - Statute of Limitations.

**Authority:** IC § 6-3-4-6 (*Effective January 1, 2011 to July, 1, 2015*); IC § 6-3-4-6(b); IC § 6-3-4-6(c); IC § 6-8.1-9-1(a); IC § 6-8.1-9-1(f) (*Effective July 1, 2012 to June 30, 2015*); IC § 6-8.1-9-1(f)(2).

Taxpayer maintains that its amended 2010 income tax return was timely filed and that the requested refund is not barred by the statute of limitations.

## STATEMENT OF FACTS

Taxpayer is an out-of-state company in the business of researching and developing "medical therapies."

Taxpayer explained that it entered into an agreement with a third-party out-of-state company to manufacture a drug developed by Taxpayer. Thereafter third-party company manufactured and sold the drug. Taxpayer received a portion of the net profit from these drug sales pursuant to a "collaboration agreement" entered into between Taxpayer and third-party manufacturer.

Taxpayer filed federal and Indiana income tax returns reporting Taxpayer's portion of the net sales. According to Taxpayer, it "reported this share of revenue as royalty income and sourced it for sales factor purposes according to the rules applicable to royalties."

The Internal Revenue Service ("IRS") audited Taxpayer's federal returns. The IRS found that Taxpayer's "collaboration agreement" with third-party manufacturer should have been "treated as a joint venture taxable as a partnership for federal tax purposes." The IRS found that this "deemed partnership" was selling the drug and that the income from these sales should have been treated as if Taxpayer "had received a distributive share income from a partnership instead of royalty income." The IRS issued a "Notice of Adjustment" which Taxpayer dated September 16, 2014. There is no indication Taxpayer provided Indiana notification of this adjustment.

Taxpayer filed an amended 2010 IT-20X Indiana income tax return reporting the "partnership" income. On that

return, Taxpayer claimed a refund of approximately $493,000. Taxpayer's amended return was dated June 29, 2017.

The Indiana Department of Revenue ("Department") responded in a letter dated November 21, 2017. In that letter, the Department denied the $493,000 refund. The Department explained:

> The federal return adjustment from the recent federal audit being reported demonstrated an increase to Indiana adjusted gross income. The supporting schedule attached to the IT-20X showed an undisclosed and unsupported apportionment factor to calculate a refund instead of demonstrating the additional tax due. This undisclosed and unsupported change to the apportionment factor is denied.

As a result of its decision, the Department issued Taxpayer a "proposed assessment" of approximately $24,000 in additional 2010 corporate income tax.

Taxpayer disagreed with the Department's decision and submitted a protest to that effect. An administrative hearing was conducted by telephone during which Taxpayer's representative explained the basis for the protest. This Final Order Denying Refund results.

**I. Corporate Income Tax - Amended Apportionment Factor.**

**DISCUSSION**

The first issue is whether Taxpayer's amended 2010 income tax return should have resulted in a $493,000 refund instead of the $24,000 assessment determined by the Department.

As with any assessment of tax, it is the Taxpayer's responsibility to establish here that the existing tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463, 466 (Ind. 2012); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007). Thus, a taxpayer is required to provide documentation explaining and supporting his or her challenge that the Department's position is wrong. Poorly developed and non-cogent arguments are subject to waiver. *Scopelite v. Indiana Dep't of Local Gov't Fin.,* 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480, 486 n.9 (Ind. Tax Ct. 2012). Consequently, a taxpayer is required to provide documentation explaining and supporting his or her challenge that the Department's position is wrong. Further, "[W]hen [courts] examine a statute that an agency is 'charged with enforcing . . . [courts] defer to the agency's reasonable interpretation of [the] statute even over an equally reasonable interpretation by another party.'" *Dept. of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579, 583 (Ind. 2014). Thus, interpretations of Indiana tax law contained within this decision are entitled to deference.

Taxpayer stated that it originally reported income from the sale of the drug as "royalty income." The provision for sourcing royalty income is found at IC § 6-3-2-2(g) and following which in relevant part provides:

> (g) Rents and royalties from real or tangible personal property, capital gains, interest, dividends, or patent or copyright royalties, to the extent that they constitute nonbusiness income, shall be allocated as provided in subsections (h) through (k).
>
> (h)(1) Net rents and royalties from real property located in this state are allocable to this state.
> (2) Net rents and royalties from tangible personal property are allocated to this state:
> (i) if and to the extent that the property is utilized in this state; or
> (ii) in their entirety if the taxpayer's commercial domicile is in this state and the taxpayer is not organized under the laws of or taxable in the state in which the property is utilized.

. . .

> (k)(1) Patent and copyright royalties are allocable to this state:
> (i) if and to the extent that the patent or copyright is utilized by the taxpayer in this state; or
> (ii) if and to the extent that the patent or copyright is utilized by the taxpayer in a state in which the taxpayer is not taxable and the taxpayer's commercial domicile is in this state.

The IRS found that Taxpayer's "collaboration agreement" with the third-party manufacturer should have been treated as a "partnership for federal tax purposes." Therefore the money received from the sale of the drug should have been treated as Taxpayer's "distributive share income . . . ." Since Taxpayer's share of the partnership income was attributable to the sale of "tangible personal property," for Indiana income tax purposes, the income is sourced pursuant to IC § 6-3-2-2(f) as follows:

> Sales, other than receipts from intangible property covered by subsection (e) and sales of tangible personal property, are in this state if:
> (1) the income-producing activity is performed in this state; or
> (2) the income-producing activity is performed both within and without this state and a greater proportion of the income-producing activity is performed in this state than in any other state, based on costs of performance.

This sourcing provision for income received from a corporate partnership is found at 45 IAC 3.1-1-153.

> (a) A corporate partner's share of profit or loss from a partnership will be included in its federal taxable income and therefore generally subject to the same rules as any other adjusted gross income.
> (b) If the corporate partner's activities and the partnership's activities constitute a unitary business under established standards, disregarding ownership requirements, the business income of the unitary business attributable to Indiana shall be determined by a three (3) factor formula consisting of property, payroll, and sales of the corporate partner and its share of the partnership's factors for any partnership year ending within or with the corporate partner's income year, with the following modifications:
> (1) The value of property which is rented or leased by the corporate partner to the partnership or vice versa shall, with respect to the corporate partner, be excluded from the property factor of the partnership or eliminated to the extent of the corporate partner's interest in the partnership, whichever the case may be, in order to avoid duplication.
> (2) Intercompany sales between the corporate partner and the partnership shall be eliminated from the corporate partner's sales factor as follows:
> (A) Sales by the corporate partner to the partnership to the extent of the corporate partner's interest in the partnership.
> (B) Sales by the partnership to the corporate partner not to exceed the corporate partner's interest in all partnership sales.
> (c) If the corporate partner's activities and the partnership's activities do not constitute a unitary business under established standards, disregarding ownership requirements, the corporate partner's share of the partnership income attributable to Indiana shall be determined as follows:
> (1) If the partnership derives business income from sources within and without Indiana, the business income derived from sources within Indiana shall be determined by a three (3) factor formula consisting of property, payroll, and sales of the partnership.
> (2) If the partnership derives business income from sources entirely within Indiana, or entirely without Indiana, such income shall not be subject to formula apportionment.
> (d) A partner's distributive share of income will be adjusted by the partner's proportionate share of the partnership's income that is exempt from taxation under the Constitution and statutes of the United States and by the partner's proportionate share of the partnership's deductions allowed or allowable under Section 63 of the Internal Revenue Code for taxes based on or measured by income and levied at the state level by any state of the United States or for taxes on property levied by any subdivision of any state of the United States.
> (e) After determining the amount of business income attributable to Indiana under subsection (c), the corporate partner's distributive share of such income shall be added to the corporate partner's other business income apportioned to Indiana and its nonbusiness income, if any, allocable to Indiana, in determining the corporate partner's total taxable income.

The Department assessed the additional tax for reasons not directly related to the IRS's decision requiring to report its income as partnership income rather than royalty income. Instead, the assessment is related to the apportionment of that income. Although Taxpayer's amended return reflected an adjustment to its apportionment of the partnership income, Taxpayer provided nothing which would have explained the apportionment calculation at the time the amended return was first filed. In response, the Department sent Taxpayer a letter March 2017 requesting that apportionment information. Taxpayer did not respond and, on November 2017, the Department issued its assessment based on the "best information available" - in this case, Taxpayer's original Indiana apportionment calculation. The Department issued the assessment in the face of the statutory requirement that such assessment be issued within six months of the date it itself received notice. IC § 6-8.1-5-2(i).

Taxpayer states that it provided the requested explanation in a letter dated December 2017. Taxpayer provided a copy of that letter and accompanying spreadsheet in support of its protest challenging the assessment.

Although the December 2017 does not on its face establish that the assessment was "wrong," the Department's Audit Division is requested to review the somewhat belated information and to make whatever adjustment to the assessment is warranted.

**FINDING**

Subject to review by the Department's Audit Division, Taxpayer's protest of the proposed assessment is sustained.

**II. Corporate Income Tax - Statute of Limitations.**

**DISCUSSION**

The second issue is whether Taxpayer's amended 2010 return, by which Taxpayer sought the $493,000 refund, was timely filed.

Taxpayer's 2010 amended Indiana return is dated June 29, 2017. On that return, Taxpayer explains that the amended return "report[s] changes pursuant to an Internal Revenue Service audit finalized March 1, 2017."

Since Taxpayer's amended return is based on a federal adjustment, the question of timeliness is addressed in IC § 6-8.1-9-1(f) (*Effective July 1, 2012 to June 30, 2015*) because that is the statute in effect at the time the IRS notified Taxpayer of the adjustment dated September 16, 2014. The statute provides as follows:

> If a taxpayer's federal income tax liability for a taxable year is modified by the Internal Revenue Service, and the modification would result in a reduction of the tax legally due, the due date by which the taxpayer must file a claim for refund with the department is the later of:
> (1) the date determined under subsection (a); or
> (2) the date that is one hundred eighty (180) days after the date on which the taxpayer is notified of the modification by the Internal Revenue Service.

IC § 6-8.1-9-1(a), referenced within the statute, is the general three-year statute of limitations in which to claim a refund. However, the issue falls within the rule found at IC § 6-8.1-9-1(f)(2); did taxpayer submit the 2010 amended return within 180 days after the date on which it was notified of the modification by the Internal Revenue Service pursuant to the requirement set out in IC § 6-3-4-6?

IC § 6-3-4-6 (*Effective January 1, 2011 to June 30, 2015*) provides:

> (a) Any taxpayer, upon request by the department, shall furnish to the department a true and correct copy of any tax return which he the taxpayer has filed with the United States Internal Revenue Service which copy shall be certified to by the taxpayer under penalties of perjury.
> (b) Each taxpayer shall notify the department of any modification of:
> (1) a federal income tax return filed by the taxpayer after January 1, 1978; or
> (2) the taxpayer's federal income tax liability for a taxable year which begins after December 31, 1977.
> The taxpayer shall file the notice on the form prescribed by the department within one hundred twenty (120) days after the modification is made if the modification was made before January 1, 2011, and one hundred eighty (180) days after the modification is made if the modification is made after December 31, 2010.
> (c) If the federal modification results in a change in the taxpayer's federal or Indiana adjusted gross income, the taxpayer shall file an Indiana amended return within one hundred twenty (120) days after the modification is made if the modification was made before January 1, 2011, and one hundred eighty (180) days after the modification is made if the modification is made after December 31, 2010.

Therefore, if the IRS adjusts a taxpayer's income tax return and the adjustment results in a "reduction" of the tax legally due, IC § 6-3-4-6(b) requires that a taxpayer file a "notice" with the Department within 180 days of that adjustment, and IC § 6-3-4-6(c) requires that a taxpayer file an amended return with the Department within 180 days of the date the taxpayer is notified of the federal adjustment.

IC § 6-8.1-9-1(f) and IC § 6-3-4-6 act in concert; if the taxpayer's federal return is modified, the taxpayer is required to give the Department notice within 180 days of the modification and is required to file an amended

return within 180 days of the modification.

Taxpayer states that the 180 day period was triggered by the March 1, 2017, "Waiver of Restrictions on Assessment and Collection of Deficiency in Tax and Acceptance of Overassessment" Form 870. Given that March date, Taxpayer states that it timely filed the Indiana amended returns. The Department is unable to agree. In Taxpayer's case, the 180 day period was triggered by the IRS "Notice of Proposed Adjustment," Form 5701, dated September 16, 2014, resulting from the IRS's determination that Taxpayer was required to report as partnership income money attributable to its business relationship with the third-party out-of-state drug manufacturer. Accepting the IRS determination as reflected in the amended Indiana return, would have allowed Taxpayer to recalculate its Indiana apportionment and obtain a refund based on that recalculation. However, given the September 2014 IRS decision and the Indiana law in effect at the time of the proposed adjustment, Taxpayer was required to provide notice of that Indiana refund with 180 days of September 16, 2014. There is no evidence Taxpayer timely provided that statutorily required notice.

**FINDING**

Taxpayer's protest of the Department's decision denying the $493,000 is respectfully denied.

**SUMMARY**

The Department's Audit Division is requested to review apportionment documentation and to make whatever adjustment is justified by that information; Taxpayer's request for a refund of 2010 corporate income tax is untimely and respectfully denied.

April 27, 2018

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